Spitfire Energy Ltd.

2005 ANNUAL REPORT

Abbreviations and Acronyms

bbl	barrel
boe	barrel of oil equivalent. The Term "boe" may be misleading, particularly if used in isolation. A boe conversion ratio of 6 Mcf per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.
boed	barrel of oil equivalent per day
BTPV	Before tax present value
Mcf	one thousand cubic feet of natural gas
Mcfd	one thousand cubic feet per day
MDT	Mountain Daylight Time
mmbtu	one million British thermal units
MMcf	one million cubic feet of natural gas
MMcfd	one million cubic feet per day
OPEC	Organization of Petroleum Exporting Countries
P&NG	Petroleum and natural gas
WTI	West Texas Intermediate
$	Canadian dollar
US$	United States of America dollar

Spitfire Energy Ltd.

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Corporate Profile

Spitfire Energy Ltd. ("Spitfire" or the "Company") is an emerging junior oil and gas company based in Calgary, Alberta. The Company's business strategy involves a conservative approach to growth in net asset value per share by drilling internally generated exploitation opportunities, optimizing production and reducing operating costs. Spitfire has a strong balance sheet and an inventory of land, seismic and drilling locations for multi-zone natural gas and medium oil prospects.

Notice of Annual and Special General Meeting

The Annual Meeting of shareholders of Spitfire will be held at 2:00 p.m. (MDT) on Thursday, September 8, 2005 in the boardroom of Burstall Winger 3100, 324 - 8th Ave. S.W. of Calgary, Alberta. Shareholders are encouraged to attend the meeting. Those unable to attend are urged to complete, sign and return their form of proxy mailed with this report at least 48 hours prior to the meeting.

Forward-Looking Statements

This document may contain forward-looking statements, including statements relating to management's approach to operations, expectations relating to the number of wells, amount and timing of capital projects, interest rates, worldwide and industry production prices of oil and natural gas, Company production, cash flow and debt levels. These forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of the Company to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The reader is cautioned that assumptions used in the preparation of such information, although considered reasonable by Spitfire at the time of preparation, may prove to be incorrect.

President's Message

Fellow Shareholders, July 28, 2005

Thank you for your patience and support during Spitfire's first year of getting off the ground. Our takeoff took longer than we had hoped, but we have started our ascent, climbing to more than 215 barrels of oil equivalent per day (boed) at present from an average of 35 boe/d in the year ending March 31, 2004. We have added more than 750,000 barrels of oil equivalent (boe) to last year's 239,100 boe for a total of 990,000 boe, bought land and shot seismic for future drilling opportunities and increased the Company's net asset value from management's estimate of $0.22 per share to greater than $0.65 per share. We are proud of our very successful year and have a solid foundation from which to continue this trend.

Highlights

- We raised $4 million in a major equity offering and an additional $1 million from the exercise of agent options and warrants.
- We shot seismic, drilled and completed a natural gas well at Alderson, Alberta. The well is currently awaiting tie-in or sale to the operators in control of facilities in the area. Our independent engineering evaluation has estimated the present value of the total proved and probable reserves at a 10% discount rate for this well, to be $636,000.
- We drilled a natural gas and oil well at Fosterton, Saskatchewan that is currently producing over 125 boed. Our interest is 100%. Our independent engineering evaluation has estimated the present value of the total proved and probable reserves at a 10% discount rate for this well, to be $2,944,000. This extremely successful well has led us to shooting 3D seismic over our pool and has resulted in at least four follow-up locations for drilling. These follow-up locations are awaiting environmental protection plan approval and we expect to drill them this winter.

- We expanded our battery at Fosterton to accommodate increased production.
- We installed a gas compressor at Fosterton that now ties in our solution gas for sales.
- We have consolidated interests in core areas, including four asset acquisitions, one asset disposition and one corporate acquisition at a cost of approximately $1.5 million.
- We acquired over 5,000 kilometres of 2D seismic data in south central Alberta and the services of a geophysical consultant familiar with the data. This has lead to numerous exploration drilling locations.

2005 Outlook

Our 2005 capital budget is $4.4 million, including drilling seven (4.6 net) wells, re-completing four wells and allocating more than $1 million to land and seismic for future opportunities. This budget will be financed predominately from cash flow, moderate debt and possibly a small equity injection.

This is our second annual report to shareholders and the financial statements reflect the early phase of growth. We have a solid base from which to execute our growth strategy. We have identified more than 12 high quality drilling opportunities. We have the land, discretionary cash flow, access to debt and capital with which to exploit these opportunities along with the people in place to get the job done. We will execute our plan to drill and recomplete wells and as a result we fully expect to add significant shareholder value in the next 12 months. We will continue to build an inventory of opportunities for the next stages that may be financed entirely with cash flow. Our major focus is growth by drilling exploitation opportunities, but we continually seek a larger corporate or asset acquisition that is accretive to our shareholders. Our tolerance to risk is limited to $500,000 per opportunity, expecting a minimum risked rate of return of 15% for projects with a 70% to 90% chance of success and a risked rate of return of 20% for higher risk projects.

The Spitfire team has been enhanced with the addition of Dan Zivkusic as our Chief Financial Officer commencing August 1, 2005. His financial accounting

expertise and extremely high "buy in" place him solidly in the Spitfire cockpit. Our team is well rounded and highly experienced with two geologists, an engineer, two accountants, a geophysical consultant, two operations consultants and an office manager joining me to build Spitfire into a significant company. Together our team has an average of 26 years of industry experience. We operate the vast majority of our assets, giving us greater control over day-to-day business.

Conclusion

In the past year we have expanded our base and have set the stage for significant growth. The strength and experience of Spitfire staff, our strategy of exploiting the numerous low-risk, moderate reward opportunities combined with securing the rights to drill some moderate risk, higher reward gas plays, are expected to continue to add significant shareholder value.

The Spitfire team is excited about the coming year as we continue to grow the Company and add value for shareholders.

K. N. (Keith) Chase
President and Chief Executive Officer

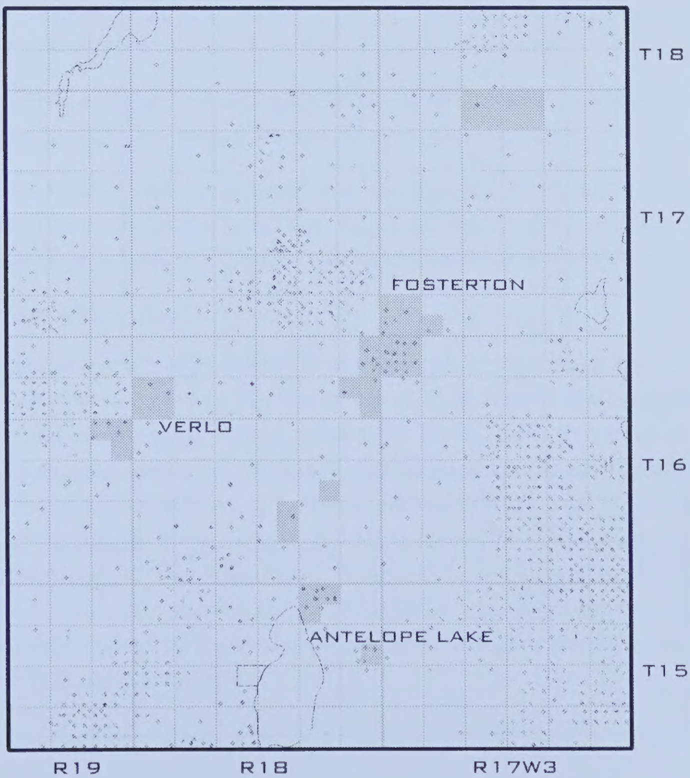
Exploration and Operations Review

Strategy

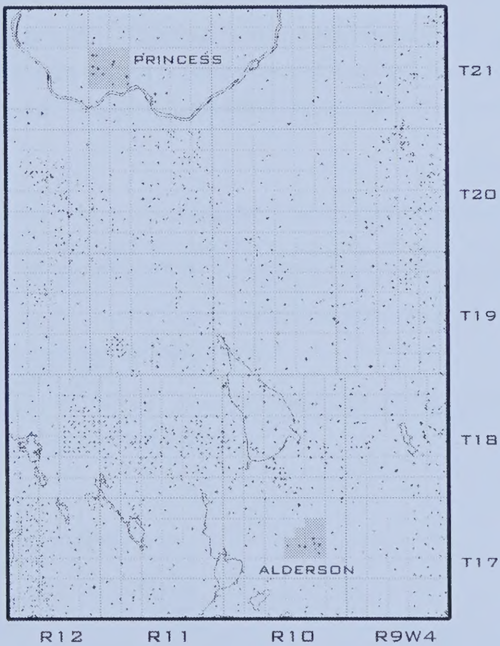
Spitfire management has a well-defined business strategy. The Company's goal is to deliver solid per share growth in reserves, production and cash flow by way of the drill bit, supplemented with strategic acquisitions in Spitfire's core areas.

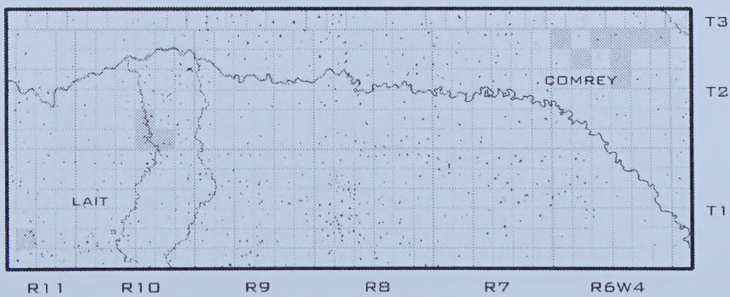
Core Areas

Southwest Saskatchewan (Fosterton/Antelope/Verlo)



Southeast Alberta (Alderson/Princess/Suffield/Comrey/Lait)





Operations Statistical Review

Spitfire's revenues are largely derived from medium crude production with high water cuts and associated natural gas. The majority of Spitfire's capital budget for 2005 is devoted to differentiate its product mix. The Company is focusing its efforts on gas prospects to accomplish this diversity. Production and lifting costs for the year ending March 31, 2005 were $13.75 per boe. The Company's target is $7.50 per boe and measures are constantly being taken to achieve this goal. To offset the negative effects of high lifting costs, Spitfire continually manages its operation to achieve production declines of less than 10% and to date has attained minimal decline with minimal capital expenditure. Spitfire budgets one pump workover per well per year and this is included in the lifting costs.

Spitfire contracts seismic and drilling operations to third parties and it manages well completions, re-completions, tie-ins and workovers internally.

Spitfire has internal expertise for crude and natural gas marketing and currently has no contract for a term exceeding 30 days. All products are sold into the daily market index in the case of natural gas and monthly postings in the case of oil.

Drilling Program

Spitfire drilled one well at Fosterton and one well at Alderson in fiscal 2005, both with a 100% working interest. The Fosterton well is currently producing medium crude oil and solution gas at rates in excess of 125 boed. This well initiated the nine square kilometre 3D seismic program over the field and its likely extension that resulted in a minimum of four new locations awaiting EPP approval. The Alderson well was based on our 16 square kilometre 3D and tested 140 Mcfd with a water/gas ratio of 288 barrels per MMcf. It currently is shut-in awaiting tie-in or sale. The Alderson 3D illustrated additional targets in other zones that resulted in Spitfire acquiring more land over these targets. Spitfire is currently seeking partners to drill these new opportunities.

Production

Spitfire's average daily production for the period ending March 31, 2005 was 53 boed. This production was lower than expected due to the limited availability of service rigs and warm winter delaying completion and tie-in activities. Our June 2005 net production rate was 103 boed.

Land Holdings

Area	Gross Undeveloped Acres	Net Undeveloped Acres	Gross Net Developed Acres	Net Developed Acres
Saskatchewan	5,523	4,823	1,157	476
Alberta	12,714	4,286	2,880	1,414
Royalty	480	-	2,719	-
Total	18,717	9,109	6,756	1,890

Management's Discussion and Analysis

July 28, 2005

The following discussion and analysis should be read in conjunction with the Company's financial statements for the 12-month period ended March 31, 2005. This Management's Discussion and Analysis ("MD&A") includes information available to management through to July 28, 2005 and includes significant progress not included in the financials. Additional information relating to the Company is available on SEDAR at www.sedar.com and in the near future at our website www.SpitfireEnergy.com.

Business Strategy

Spitfire management has a well-defined business strategy to capture opportunities necessary to provide net asset value per share growth. The Company's corporate strategy involves the following key principles:

- Attract and retain top quality technical staff with proven track records;
- Focus on cost-effective, per share growth in reserves, production and cash flow by;
  - Drilling and production optimization;
  - Asset acquisitions;
  - Maintain strict cost controls; and
  - Maintain a solid balance sheet and a conservative debt to cash flow ratio.

Management believes this business strategy allows Spitfire to effectively compete for capital and assets in the maturing Western Canada Sedimentary Basin.

Financial Highlights

	March 31, 2005	Per Basic Common Share
Gross production revenue	$715,317	$0.03
Net loss before related party transaction	($277,993)	($0.01)
Working capital	($307,271)	($0.01)
P&NG assets BTPV 8% constant prices	$12,959,000	$0.63
Basic common shares outstanding	20,511,011	

Operational Highlights

	Period ended March 31, 2005
Production - boed at 6:1	53
Weighted average production prices ($Cdn @ 6:1)	$37.16
Net / gross operated wells	12.7 / 23
Average interest	(55%)
Net / gross non-operated wells	1.2 / 21
Average interest	(6%)
Drilling success rate	75%

During the fourth quarter of fiscal 2005 the Company averaged 66 boed with a weighted average price of $36.47 per boe.

Liquidity and Capital Resources

Spitfire commenced operations on August 30, 2002 and completed its qualifying transaction on November 27, 2003 to become a Tier II issuer on the TSX Venture Exchange. In June 2004, Spitfire raised $3,999,950 ($3,605,660 net after share issue costs) of equity. As at March 31, 2005, the Company's working capital was ($307,271).

Capitalized assets for the 12-month period ending March 31, 2005, (excluding the business acquisition), and the 15 month period ending March 31, 2004 were as follows:

	12 months ending March 31, 2005	15 months ending March 31, 2004
Land and lease	$672,593	$1,096,152
Geological and geophysical	$841,845	$66,038
Drilling	$1,065,198	$131,296
Facilities and equipment	$593,690	$257,866
Asset retirement obligation	$36,422	$64,329
Total	$3,209,748	$1,615,681

Spitfire has insufficient capital to evaluate the opportunities in its portfolio and will seek additional equity or debt to finance opportunities as deemed appropriate by management. Our forecast of cash flows from operations exceeds general and administrative expenses by $1.1 million, allowing for capital investment. Additionally, the Company is in discussion with its bank for an expanded line of credit which is expected to be up to $2 million plus a line of credit of $500,000 for developing probable reserves.

Shares Outstanding

As at June 30, 2005 Spitfire had 23,042,744 common shares outstanding. In addition, it has issued 1,878,500 options to employees and consultants at a weighted average exercise price of $0.19 per share. On a fully diluted basis there are 24,921,274 common shares outstanding, of which 2,655,001 are held in escrow.

General and Administrative Expenses

As at March 31, 2005, Spitfire incurred administrative expenses associated with start-up as follows:

	12 months ending March 31, 2005	15 months ending March 31, 2004
Salaries and benefits	$19,136	-
Professional fees	$284,418	$48,463
Rent and office costs	$111,429	$42,872
Public company associated costs	$90,017	$40,092
Information systems	$26,936	$23,460
Insurance	$6,474	-
General and administrative recoveries	($46,159)	($6,950)
Capitalized	($109,613)	($40,154)
Total	$382,638	$107,783

Stock Based Compensation Expenses

For share options granted to March 31, 2005, the total stock based compensation was $135,128. In total, $98,540 was expensed and $36,588 was capitalized to property and equipment that was associated with technical staff.

Interest Income and Expense

$13,995 in interest expense was incurred in the year ended March 31, 2005 that was offset by $39,608 in interest income. Notes payable and debenture interest

amounted to $11,532 with the balance of $2,463 being for accrued interest on flow through funds raised but unspent. Interest was earned on cash held in deposits amounting to $33,859 and $5,749 was earned from a loan to a related party that was paid in full during February 2005.

Depletion and Depreciation

Depletion and accretion, excluding the business acquisition, amounted to $128,464 for the period ending March 31, 2005.

Income Taxes

There are no current income taxes due for the period ending March 31, 2005. A change in Company expenditures, production, commodity prices and renouncements could change the Company's tax situation in the future. The Company has future income tax pools of $2,419,046 and non-capital losses of approximately $606,644 as indicated in Note 6 of the consolidated financial statements. Spitfire's consolidated tax pools are as:

Canadian exploration expense(CEE)	$254,983
Canadian development expense(CDE)	$150,136
Canadian oil and gas property expense(COGPE)	$1,267,438
Capital cost allowance(CCA)	$746,489
Non-capital losses	$606,644
Total	$3,025,690

Net Income and Future Profitability

The future profitability of the Company has been significantly enhanced with our latest successes. Positive net earnings are forecasted for the 2006 fiscal year but they depend, as always, on product prices and operating costs, most of which are beyond the control of the Company and its management.

Related Party Transactions

Spitfire entered into management contracts with companies owned and controlled by the President and Vice-President, Exploration which provided for, inter alia,

services of the individuals comprising substantially all of their time in exchange for $80,000 per year, parking and a severance fee in the event the contract is terminated by the Company or there is a change of control of the Company.

Spitfire acquired Spitfire Exploration Ltd. on March 31, 2005 and the two companies were amalgamated on April 1, 2005. Details of this transaction are noted in the financial statements in Note 3.

Spitfire intends to complete a private placement to two key employees for 1,160,000 common shares at a price of $0.27 per share for gross proceeds of $301,600. Related to this private placement, the Company intends to loan these employees $233,600 by way of a collateralized demand note bearing interest at prime plus 1%. These shares will be issued subject to an escrow agreement releasing 10% thereof upon closing and 15% on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date.

OUTLOOK

Prospects for continued per share growth in reserves, production and cash flow at Spitfire are excellent.

Spitfire has positioned itself with a solid base of operated, long-life medium oil reserves and production. Since its inception, Spitfire has spent approximately $5.56 million of capital to grow as an exciting junior oil and natural gas company that has the following key characteristics:

- High-quality assets, strategically focused in two areas - with more than 90% operatorship and high working interests;
- 990,000 barrels of oil equivalent ("boe") of proved plus probable oil and natural gas reserves, independently evaluated in accordance with National Instrument 51-101;
- A proved plus probable reserve life index of 11 years;
- Current production of more than 215 boed, with 54% medium oil and 46% natural gas;
- 22,274 gross acres of leasehold, 10,999 net for an average working interest of 46%, plus, 3,199 gross royalty acres;
- A current internal inventory of more than 12 drilling locations, providing the potential of significant reserve additions.

Corporate Governance

Spitfire's Board of Directors ("the Board"), work together with management, striving to ensure that the Company's corporate governance practices provide effective stewardship and efficient operation of the Company in the best interests of its shareholders.

The Board, which functions independent of management, meets throughout the year to consider a wide range of issues affecting Spitfire, including strategic direction, compensation, reserves, financial performance and disclosure. The Board reviews strategic plans proposed by management, business risks facing the Company and management's assessment of those risks.

Industry Conditions

Generally speaking, industry fundamentals for the Canadian oil and natural gas sector were very strong in 2004. In 2004, world crude oil prices averaged US$41.38 West Texas Intermediate ("WTI") per barrel, significantly above the historical average. Crude oil inventories remain low due to the strong Asian demand, the slow return of Iraqi oil production to market, OPEC's ability to increase production to match demand and OPEC's aggressive-management of production quotas. These factors, together with the weakening of the US dollar and the continued threat of international terrorism, provide the basis to keep crude oil prices high into 2006. The majority of the Company's production is medium crude oil and it trades at a discount to West Texas Intermediate and Light Sweet Crude at Edmonton. The US$41.34 paid for WTI equated to CDN$52.96 at Edmonton and CDN$36.68 at the point of sale for Spitfire's Fosterton crude oil in 2004. This differential equals US$12.54 to WTI for the majority of the Company's crude sales. This differential is influenced positively with a weak Canadian dollar and seasonal summer demands.

The prime interest rate in Canada remained low in 2004, averaging 4% per annum. It is expected that Canadian interest rates will remain low in 2005.

The US/Canadian dollar exchange rate averaged US$0.77 per Canadian dollar at in 2004. The appreciation in the Canadian dollar was primarily a result of the weakening US dollar based on the economic slowdown in the United States.

RESERVES

Gilbert Laustsen Jung Associates Ltd. ("GLJ") prepared a Reserve Assessment and Evaluation of Canadian Oil and Gas Properties in accordance with National Instrument 51-101, Standards of Disclosure for Oil and Gas Activities ("NI 51-101") at the request of the Company ("GLJ Report"). The GLJ Report evaluated Spitfire's oil, natural gas liquids and natural gas reserves as at March 31, 2005.

The following tables provide a summary of the oil, natural gas liquids and natural gas reserves of Spitfire and the net present value of future revenue attributed to such reserves as evaluated in the GLJ Report, based on constant and forecast price and cost assumptions. The tables summarize the data contained in the GLJ Report, and as a result may contain slightly different numbers than such report due to rounding. Also due to rounding certain columns may not add exactly.

The term "boe" (barrel of oil equivalent) may be misleading, particularly if used in isolation. A boe conversion ratio of six Mcf per barrel is based on an energy equivalency conversion method primarily applicable at the burner tip and does not represent a value equivalency at the wellhead.

In the table, "Total Company Interest" is the Company's gross reserves, which reflect the Company's working interest including royalty interests owing to the company, (operating or non-operating) before deduction of royalties. Net reserves reflect the Company's working interest (operating or non-operating) share after deduction of royalty obligations plus the Company's royalty interests in reserves.

The net present value of future net revenue attributable to Spitfire's reserves is stated without provisions for interest costs and general and administrative costs, but after providing for estimated royalties, production costs, development costs, other income, future capital expenditures, and well abandonment costs for only those wells assigned reserves by GLJ. It should not be assumed that the undiscounted or discounted net present value of future net revenue attributable to Spitfire's reserves estimated by GLJ represents the fair market value of those reserves. Other assumptions and qualifications relating to costs, prices for future production and other matters are summarized herein. The recovery and reserve estimates of Spitfire's oil, natural gas liquids and natural gas reserves provided herein are

estimates only and there is no guarantee that the estimated reserves will be recovered. Actual reserves may be greater than or less than the estimates provide hereon.

Summary of Oil and Natural Gas Reserves

MARKETABLE RESERVES (thousands of boe)	Forecast Prices and Costs			Constant Prices and Costs		
	Total Proved	Total Probable	Total Proved Plus Probable	Total Proved	Total Probable	Total Proved Plus Probable
Total Company Interest	587	378	964	608	382	990
Net after Royalties	491	322	813	508	324	833

Before Tax Net Present Value of Future Net Revenue ($000)

	Forecast Prices and Costs			Constant Prices and Costs		
	Total Proved	Total Probable	Total Proved Plus Probable	Total Proved	Total Probable	Total Proved Plus Probable
0%	6,746	5,819	12,565	12,764	9,569	22,333
5%	5,612	4,160	9,772	9,310	6,156	15,466
8%	5,067	3,465	8,531	7,979	4,980	12,959
10%	4,753	3,097	7,851	7,280	4,396	11,676
12%	4,474	2,790	7,264	6,693	3,922	10,615
15%	4,110	2,416	6,526	5,971	3,359	9,331
20%	3,619	1,955	5,574	5,064	2,684	7,748

After Tax Net Present Value of Future Net Revenue ($000)

	Forecast Prices and Costs		Constant Prices and Costs	
	Proved	Total Proved Plus Probable	Total Proved	Total Proved Plus Probable
0%	4,995	8,351	8,752	14,398
5%	4,195	6,612	6,463	10,081
8%	3,792	5,782	5,565	8,464
10%	3,556	5,318	5,090	7,630
12%	3,345	4,914	4,688	6,936
15%	3,069	4,402	4,191	6,091
20%	2,694	3,737	3,562	5,043

Price Assumptions

The following table shows the pricing assumptions utilized by GLJ in their evaluation of the Company assets.

	WTI Crude at Cushing $US/bbl	$/US$	Crude at Edmonton $C/bbl	Med. Crude at Cromer, Sask. $C/bbl	Natural Gas - Sask. Plant Gate $/mmbtu
2005	53.00	0.82	64.25	55.00	7.35
2006	50.00	0.82	60.00	52.25	7.10
2007	47.50	0.82	57.25	49.75	6.85
2008	45.00	0.82	54.25	47.25	6.65
2009	42.00	0.82	50.50	44.00	6.40
2010	40.00	0.82	48.00	41.75	6.40
2011	40.00	0.82	48.00	41.75	6.40
2012	40.00	0.82	48.00	41.75	6.40
2013	40.50	0.82	48.75	42.50	6.55
2014	41.25	0.82	49.50	43.00	6.65
2015	41.75	0.82	50.25	43.75	6.75

Constant prices forecast were based on March 31, 2005 prices equal to US$55.40 per barrel for WTI crude oil at Cushing, Oklahoma and US$7.65 per mmbtu at Henry Hub, Louisiana.

Contractual Obligations and Commitments

Spitfire has executed a sublease agreement for use of office space which expires April 30, 2006 at a rate of $5,519 per month ($49,671 total). Spitfire has no other contractual obligations (other than operational contracts regarding leasehold) in excess of 30 days including, hedging, production purchase and transportation agreements.

Critical Accounting Policies

The financial statements have been prepared in accordance with Canadian Generally Accepted Accounting Principles ("GAAP"). A summary of significant accounting policies is presented in Note 2 to the financial statements. Most accounting policies are mandated under Canadian GAAP and therefore do not have the ability to select alternatives. However, in accounting for oil and gas activities, companies have a choice between two acceptable accounting polices: the full-cost and the successful efforts method of accounting.

The Company follows the full-cost method of accounting for oil and natural gas activities. Using the full-cost method of accounting, all costs of acquiring, exploring and developing oil and natural gas properties are capitalized, including unsuccessful drilling costs and administrative costs associated with acquisitions and development.

Under the Company's full-cost method of accounting, an impairments test is applied to the overall carrying value of property, plant and equipment, for a Canada-wide cost centre, with the reserves valued using estimated future commodity prices at period end.

Critical Accounting Estimates

The preparation of financial statements in accordance with Canadian GAAP requires management to make certain judgments and estimates. Changes in these

judgments and estimates could have a material impact on the Company's financial results and financial condition. The process of estimating reserves is critical to several accounting estimates. It requires significant judgments based on available geological, geophysical, engineering and economic data. These estimates may change substantially as data from ongoing development and production activities becomes available, and as economic conditions impacting oil and natural gas prices, operating costs and royalty burdens change. Reserve estimates impact net income through depletion, the determination of the asset retirement obligation and the application of an impairment test. The reserve estimates are also used to assess the borrowing base for the Company's credit facility. Revisions or changes in the reserve estimates can have either a positive or negative impact on net income or the borrowing base.

Management's estimates of oil and natural gas prices in determining future cash flows are also material as these prices are used in the cost centre impairment test. The carrying amount of property and equipment as well as amounts recorded for depletion can be affected by the future price estimates.

Standards of Disclosure for Oil and Gas Activities

Effective September 20, 2003, the Alberta Securities Commission implemented NI 51-101, "Standards of Disclosure for Oil and Gas Activities," NI 51-101 is effective for fiscal years that include or end December 31, 2003. The instrument imposes more standardized and more conservative guidelines for reserve estimates. Definitions for disclosure of reserves, net asset value, netbacks and finding and development costs are also provided in NI 51-101.

Continuous Disclosure Obligations

The Canadian Securities Administrators issued National Instrument 51-102 ("NI 51-102"), "Continuous Disclosure Obligation," effective for interim Management's Discussion and Analysis ("MD&A") disclosures for the first quarter ending June 30, 2004. The instrument outlines enhanced requirements for disclosure in annual and interim MD&A. The instrument also proposes shorter reporting deadlines for annual and interim financial statements and MD&A.

Full-Cost Accounting Guideline

The Canadian Institute of Chartered Accountants ("CICA") issued Accounting Guideline 16, "Full Cost Accounting": for years beginning on or after January 1, 2004. The new guideline updates reserve definitions to include the standards of NI 51-101, sets criteria for accounting for disposals of properties and defines the method to be used to deplete and depreciate capitalized costs. The guideline also sets standards for presentation and disclosure under full-cost accounting. The Company had proactively adopted this guideline for the period ending March 31, 2004 to reflect the changes to oil and gas reserve measurement that have resulted from NI 51-101. Adoption of the guideline has not materially affected the Company.

Stock Based Compensation

In September 2003, the CICA amended section 3870 of the CICA Handbook, "Stock Based Compensation and Other Stock Based Payments." The amendment requires that companies recognize as expense in the financial statements for stock based payments on the fair value method beginning January 1, 2003. The Company had proactively adopted this standard for the period ended March 31, 2004 in accordance with early adoption provisions.

Disclosure of Guarantees

The CICA issued Accounting Guideline 14, "Disclosure of Guarantees" in February 2003. This guideline requires disclosure of all guarantees, their fair value and a description of their nature in the notes to the financial statements. The new guideline is effective for fiscal years beginning on or after January 1, 2003. Adoption did not affect the financial results of the Company in the period ending March 31, 2005.

Asset Retirement Obligations

In December 2002, the CICA issued Handbook Section 3110, "Asset Retirement Obligation". This standard requires recognition of a liability representing the fair value of the future retirement obligations associated with property, plant and equipment. This fair value is capitalized as part of the cost of the related asset and

amortized to expense over its useful life. The standard is effective for all fiscal years beginning on or after January 1, 2004, Spitfire first adopted this standard for the period ending March 31, 2004.

Risk Management

Spitfire has the internal expertise to maintain a commodity price risk management program. Typically, a portion of the pricing upside would be surrendered in return for protection against a significant downturn in prices. The program would be intended to provide a measure of stability to the Company's cash flow and support towards realizing positive economic returns from Spitfire's capital development and acquisition activities. At the current time Spitfire has decided not to place hedges because daily production volumes are not sufficient to offset deliverability risks. We required a minimum of 500 boed to consider implementing a program.

Business Conditions and Risks

The business of exploration, development and acquisition of oil and gas reserves involves a number of uncertainties and as a result, the Company is exposed to a number of risks inherent in the oil and gas industry. Operationally, the Company faces risks that are associated with finding developing, and producing oil and gas reserves. These include risks associated with drilling, economic risk environmental and safety concerns and access to processing faculties. The financial risks that are not within the Company's control include the fluctuations in commodity prices and interest rates, as well as access to capital.

Management's Statement of Responsibilities

The accompanying consolidated financial statements of Spitfire were prepared by and are the responsibility of management. They have been prepared in conformity with Canadian generally accepted accounting principles. The financial information in the annual report has been reviewed to ensure consistency with the financial statements.

Management maintains systems of internal accounting controls designed to provide reasonable assurance that all transactions are properly recorded in the Company's book of accounts, that procedures and policies are adhered to and that assets are safeguarded from unauthorized use.

Meyers Norris Penny LLP, an independent firm of chartered accountants, has been engaged, since the inception of the Company to examine the consolidated financial statements in accordance with Canadian generally accepted auditing standards and provide an independent auditors' report thereon.

The Company's audit committee is composed of three members of the Board of Directors and meets quarterly with Company's management. The external auditors of the Company have access to the audit committee to review the planning and scope of testing and to discuss the results of their audit and issue a management letter at the conclusion of their review. On the recommendation of the audit committee, the Board has approved the consolidated financial statements.

Spitfire Energy Ltd.

Consolidated Financial Statements

For the periods ended March 31, 2005 and 2004

Management's Responsibility

To the Shareholders of Spitfire Energy Ltd.:

Management is responsible for the preparation and presentation of the accompanying consolidated financial statements, including responsibility for significant accounting judgments and estimates in accordance with Canadian generally accepted accounting principles and ensuring that all information in the annual report is consistent with the statements. This responsibility includes selecting appropriate accounting principles and methods, and making decisions affecting the measurement of transactions in which objective judgment is required.

In discharging its responsibilities for the integrity and fairness of the consolidated financial statements, management designs and maintains the necessary accounting systems and related internal controls to provide reasonable assurance that transactions are authorized, assets are safeguarded and financial records are properly maintained to provide reliable information for the preparation of financial statements.

The Board of Directors has appointed an Audit Committee, consisting of Directors who are not employees of the Company. The Audit Committee is responsible for overseeing management in the performance of its financial reporting responsibilities, and for approving the financial information included in the annual report. The Audit Committee has the responsibility of meeting with management, and the external auditors to discuss the internal controls over the financial reporting process, auditing matters and financial reporting issues. The Audit Committee is also responsible for recommending the appointment of the Company's external auditors.

Meyers Norris Penny LLP, an independent firm of Chartered Accountants, was appointed by the shareholders to audit the consolidated financial statements and report directly to them; their report follows. The external auditors have full and free access to, and meet periodically and separately with, both the Audit Committee and management to discuss their audit findings.

July 11, 2005

Keith N. Chase

John G. Lastuka

To the Shareholders of Spitfire Energy Ltd.:

We have audited the consolidated balance sheets of Spitfire Energy Ltd. as at March 31, 2005 and March 31, 2004 and the consolidated statements of loss and deficit and cash flows for the periods then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance as to whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial positions of the Company as at March 31, 2005 and March 31, 2004 and the results of its operations and its cash flows for the periods then ended in accordance with Canadian generally accepted accounting principles.

Meyers Norris Penny LLP

Calgary, Alberta
July 11, 2005

Chartered Accountants

Spitfire Energy Ltd.
Consolidated Balance Sheets
As at March 31,

	2005	2004 (Restated - Note 16)
Assets		
Current		
Cash	**189,901**	22,386
Accounts receivable and deposits	**458,763**	113,785
	648,664	136,171
Property and equipment *(Note 4)*	**4,525,268**	1,264,157
Future income taxes *(Note 6)*	**-**	47,440
	5,173,932	1,447,768
Liabilities		
Current		
Accounts payable and accrued liabilities	**955,935**	156,632
Short-term debt *(Note 5)*	**-**	108,521
	955,935	265,153
Future income taxes *(Note 6)*	**408,337**	-
Asset retirement obligations *(Note 7)*	**138,421**	69,475
	1,502,693	334,628
Shareholders' Deficit		
Share capital *(Note 8)*	**4,236,571**	978,098
Contributed surplus *(Note 9)*	**290,450**	53,024
Debenture payable	**-**	200,000
Deficit	**(855,782)**	(117,982)
	3,671,239	1,113,140
	5,173,932	1,447,768

Approved on behalf of the Board of Directors

Keith N. Chase, Director

Keith W. Templeton, Director

Spitfire Energy Ltd.
Consolidated Statements of Loss and Deficit
For the periods ended March 31, 2005 and 2004

	12 Months Ended **2005**	*15 Months Ended* *2004 (Restated)*
Revenue		
Oil and natural gas revenue	**715,317**	143,841
Royalties	**(152,167)**	(32,917)
Interest	**39,608**	4,400
	602,758	115,324
Expenses		
Operating	**264,724**	57,204
General and administrative	**382,639**	107,783
Stock-based compensation	**98,540**	44,452
Interest	**13,995**	2,193
Depletion, depreciation and accretion	**134,237**	35,956
	894,135	247,588
Loss from Operations	**(291,377)**	(132,264)
Other Income		
Gain on well abandonment	**6,493**	-
Loss before income taxes	**(284,884)**	(132,264)
Provision for income taxes		
Future income tax recovery *(Note 6)*	**(6,891)**	(47,440)
Net loss	**(277,993)**	(84,824)
Deficit, beginning of year, as previously stated	**(126,543)**	(33,158)
Restatement of prior year *(Note 16)*	**8,561**	-
Deficit, beginning of year, as restated	**(117,982)**	(33,158)
	(395,975)	(117,982)
Transaction with related party *(Note 3)*	**(459,807)**	-
Deficit, end of year	**(855,782)**	(117,982)
Loss per share		
Basic and diluted *(Note 8)*	**(0.01)**	(0.02)
Weighted average number of common shares		
Basic and diluted	**20,078,261**	4,484,930

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the periods ended March 31, 2005 and 2004

	12 Months Ended 2005	*15 Months Ended 2004 (Restated)*
Cash provided by (used for) the following activities		
Operating		
Net loss	**(277,993)**	(84,824)
Depletion, depreciation and accretion	**134,237**	35,956
Gain on well abandonment	**(6,493)**	-
Stock-based compensation	**98,540**	44,452
Future income tax recovery	**(6,891)**	(47,440)
	(58,600)	(51,856)
Net increase (decrease) in:		
Non-cash working capital balances	**(174,492)**	43,200
	(233,092)	(8,656)
Financing		
Proceeds on issuance of common shares	**4,156,509**	-
Share issuance costs	**(371,046)**	(24,368)
Repayment of debenture payable	**(200,000)**	-
Advances of short-term debt	-	108,521
Repayments of short-term debt	**(108,521)**	-
	3,476,942	84,153
Investing		
Purchases and expenditures of property and equipment	**(2,561,718)**	(331,592)
Business acquisition *(Note 3)*	**(514,617)**	-
	(3,076,335)	(331,592)
Increase (decrease) in cash resources	**167,515**	(256,095)
Cash resources, beginning of year	**22,386**	278,481
Cash resources, end of year	**189,901**	22,386
Supplementary cash flow information		
Interest paid	**13,268**	457

1. **Incorporation and operations**

Spitfire Energy Ltd. ("the Company") was incorporated under the Business Corporations Act (Alberta) on August 30, 2001. The Company closed its Qualifying Transaction on November 14, 2003.

During the period, the Company entered into a Purchase and Sales agreement ("the Acquisition") with Spitfire Exploration Ltd. ("Exploration"), a non-arms length private oil and gas company, pursuant to which the Company has acquired 100% of the issued and outstanding shares of Exploration for cash consideration of $514,617 (Note 3). Effective April 1, 2005 the two companies were amalgamated and continued under the name Spitfire Energy Ltd.

During the prior period, the Company entered into a Purchase and Sales agreement with Exploration, pursuant to which the Company had acquired certain undeveloped petroleum and natural gas assets which were to be paid by the issue of a $200,000 debenture. The Company had, at it's option, up to one year from the closing date to redeem the debenture plus interest in cash or for shares at $0.50 per common share (Note 11). The effective date of this transaction was November 1, 2003 and the closing date was February 9, 2004.

Both the Qualifying Transaction and the Acquisition were with Exploration. These transactions were non-arm's-length transactions as Keith N. Chase and Massimiliano Fantuz are directors and shareholders of the Company and Keith N. Chase is the sole director and Messrs. Chase and Fantuz are the only shareholders of Exploration.

The Company is involved in the production, exploration and development of resource properties in Western Canada.

2. **Significant accounting policies**

The consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and include the following significant accounting policies:

2. Significant accounting policies *(Continued from previous page)*

Property and equipment

The Company follows the full-cost method of accounting for oil and natural gas operations. All costs for exploring for and developing oil and natural gas properties and related reserves are capitalized. Such costs include those related to lease acquisition, geological and geophysical activities, lease rentals on non-producing properties, the drilling of productive and non-productive wells, tangible equipment and that portion of administrative expenses directly attributable to exploration and development activities. Any proceeds received from the disposal of properties are normally deducted from the full-cost pool without recognition of a gain or loss, unless such disposition would alter the rate of depletion by twenty percent (20%) or more. When a significant portion of properties is sold, a gain or loss is recorded and reflected in the statement of loss and deficit.

Depletion of oil and natural gas properties and production equipment are calculated by using the unit-of-production based upon estimated proved reserves, as determined by an independent engineer. For purposes of the calculation, oil and natural gas reserves will be converted to equivalent volumes based upon relative energy content whereby one barrel of oil equals six thousand cubic feet of natural gas.

The Company records computer and office equipment at cost and provides depreciation on the declining balance method at rates varying from 20% to 30% per annum, which is intended to amortize the cost of the assets over their estimated useful lives.

Long-lived assets

Long-lived assets consist of property and equipment. Long-lived assets held for use are measured and depleted or depreciated as described in the applicable accounting policy.

The Company performs impairment testing on long-lived assets held for use

2. Significant accounting policies *(Continued from previous page)*

annually and whenever events or changes in circumstances indicate that the carrying value of long-lived assets may not be recoverable. Impairment losses of petroleum and natural gas properties are recognized when undiscounted future cash flows from the Company's proved reserves, undeveloped land and future development projects are less than their carrying value. Any impairment is included in earnings for the year.

If the carrying value is assessed not to be recoverable, an impairment loss is recognized to the extent that the carrying amount of the petroleum and natural gas properties exceeds the sum of the discounted cash flows from proved plus probable reserves, undeveloped land and future development projects. The cash flows are estimated using expected future product prices and costs and are discounted using a risk-free interest rate.

Impairment losses for property and equipment other than petroleum and natural gas properties, are recognized when the undiscounted future cash flows from their use and disposal are less than the asset's carrying value. Impairment loss is measured as the amount by which the asset's carrying value exceeds its fair value. Fair value is determined by the prices of similar items. Any impairment is included in earnings for the year.

Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the period in which it is incurred and a corresponding increase in the carrying value of the related long-lived asset. This fair value is determined through industry guidelines and management's estimate on a property by property basis.

The liability is subsequently adjusted due to the passage of time and is recognized as an accretion expense in the statement of loss and deficit. The liability is further adjusted due to revisions in either the timing or the amount of the original estimated cash flows associated with the liability.

The increase in the carrying value of the property and equipment is amortized using the unit of production method based on estimated gross proven reserves as determined by independent engineers.

2. Significant accounting policies *(Continued from previous page)*

Joint activities

Some of the Company's exploration and production activities are conducted jointly with others and accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Revenue recognition

Revenue is recognized from oil sales when the oil is delivered to the buyer and from gas sales when the gas passes through the pipeline at the delivery point.

Stock-based compensation

The fair value for each stock option granted is estimated on the date of the grant using the Black Scholes option pricing model. These fair values are recognized in current earnings or capitalized to property and equipment with a corresponding increase to contributed surplus over the vesting period of the grant. As the options are exercised, the consideration paid, together with the amounts previously recognized in contributed surplus, are recorded as an increase to share capital.

Earnings per share

The Company calculates basic earnings per share using the weighted average number of shares outstanding during the year. The Company follows the treasury stock method for the computation and disclosure of diluted per share amounts. Under this method, the diluted weighted average number of common shares outstanding is calculated by assuming proceeds from the exercise of dilutive ("in the money") options are used to purchase common shares at the average market price.

Income taxes

The Company uses the asset and liability method of accounting for income taxes. Under this method, future income tax liabilities and assets are recognized for the estimated tax consequences attributable to differences between the amounts reported in the financial statements and their respective

2. Significant accounting policies *(Continued from previous page)*

tax basis using tax rates that are expected to be in effect when the related income and expense items are expected to be realized. The effect of a change in income tax rates on future income tax liabilities and assets is recognized in income in the period that the change occurs. In addition, the future benefits of income tax assets, including unused tax losses are recognized, subject to a valuation allowance, to the extent that it is more likely than not that such future benefits will ultimately be realized.

Flow through shares

Share capital includes flow through shares issued pursuant to certain provisions of the Income Tax Act (Canada) ("the Act"). Under the Act, where the proceeds are used for eligible expenditures, the related income tax deductions may be renounced to subscribers.

Share capital is reduced by an amount equal to the estimated future income taxes payable by the Company as a result of the renunciations and the estimated future income taxes payable are recorded as an increase to the future income tax liability when the expenditures are renounced to the shareholders.

Measurement uncertainty

The preparation of financial statements in conformity with Canadian generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Accounts receivable are stated after evaluation as to their collectibility and an appropriate allowance for doubtful accounts is provided where considered necessary. The amounts recorded for depletion and depreciation of property and equipment and the provisions for asset retirement obligations are based on estimates. The impairment test is based on such factors as estimated proven reserves, production rates, oil and natural gas prices, future costs and other relevant assumptions.

2. Significant accounting policies *(Continued from previous page)*

By their nature, these estimates are subject to measurement uncertainty and the impact on the financial statements of future periods could be material if actual results differ from these estimates.

3. Business Combination

On March 31, 2005, the Company acquired 100% of the outstanding common shares of Spitfire Exploration Ltd. ("Exploration"), a company related through common control, for total cash consideration of $514,617 and the issue of 4,250,000 shares of the Company in the amount of $420,992 for a total consideration of $935,609. As the effective date of the transaction is the year end date of the Company no results of Exploration's operations are included in these financial statements. The shares of the company acquired in the acquisition have been cancelled and charged to share capital.

The transaction has been recorded at the carrying amount of the assets and liabilities as recorded in the accounts of Exploration. The difference between the consideration paid and the carrying amount of net assets acquired has been charged to retained earnings. The transaction was accounted for as an acquisition of Exploration by the Company using the purchase method of accounting.

The following table summarizes the carrying value of the assets acquired and liabilities assumed on the date of acquisition.

As at	March 31, 2005
Book value of net assets acquired:	
Current assets	317,986
Property and equipment	180,268
Investment	420,992
Total assets acquired	919,246
Current liabilities	371,763
Future income taxes	37,974
Asset retirement obligations	33,707
Total liabilities assumed	443,444
Book value of net assets acquired	475,802

3. Business Combination *(Continued from previous page)*

On March 1, 2004, the Company acquired all of the issued and outstanding shares of Cashel Resources Inc. ("Cashel") for consideration of 769,948 common shares of the Company valued at $269,482. The transaction was accounted for as an acquisition of Cashel by the Company using the purchase method of accounting.

As at	March 31, 2005
Book value of net assets acquired:	
Working capital	81,460
Property and equipment	188,022
Book value of net assets acquired	269,482

4. Property and equipment

			2005	2004
	Cost	Accumulated amortization	Net book value	(Restated) Net book value
Computer and office equipment	**39,687**	**17,485**	**22,202**	750
Petroleum and natural gas properties	**5,564,259**	**1,061,193**	**4,503,066**	1,263,407
	5,603,946	**1,078,678**	**4,525,268**	1,264,157

As at March 31, 2005, unproved properties with capitalized costs of $896,414 (2004 - $224,766) were not subject to depletion.

During the year, property and equipment additions, excluding the business acquisition, totaled $3,209,748 (2004 - $1,516,621) of which $575,020 (2004 - nil) were accrued in accounts payable and accruals, $36,422 (2004 - $69,475) were due to asset retirement obligations, $36,588 (2004 - $8,572) were due to capitalized stock-based compensation, nil (2004 - $906,982) were due to the non-cash portion of business acquisitions, nil (2004 - $200,000) were due to a debenture issued and $2,561,718 (2004 - $331,592) were acquired with cash.

4. **Property and equipment** *(Continued from previous page)*

During the year ending March 31, 2005, the Company capitalized geological and geophysical expenses of $110,614 (fifteen month period ending March 31, 2004 - $145,045) and stock-based compensation for geological and geophysical services of $46,829 (fifteen month period ending March 31, 2004 - $8,572).

Based on the results of exploration activities and the year - end impairment test, management has provided for no write down (2004 - nil) of petroleum and natural gas properties. The future commodity prices used in the impairment test were based on March 31, 2005 commodity price forecasts of the Company's independent reserve engineers adjusted for differentials specific to the Company's reserves as follows:

	Crude $Cdn/bbl	Gas $Cdn/mmbtu
2006	44.03	6.96
2007	41.87	6.72
2008	39.46	6.52
2009	36.38	6.32
2010	33.99	6.32

The escalation rate of the above prices after 2010 is 2.0%

5. **Short-term debt**

The Company had temporarily used a credit facility via a non-arms length partner to secure a line of credit. The Company was entitled to a line of credit of $169,300 of which $108,521 was expended to March 31, 2004. This balance was repaid on May 31, 2004.

Credit facilities

The Company has available a revolving operating demand loan with a maximum available credit of $260,000, bearing interest at prime plus 1.0% and secured by a general assignment of book debts and a $5,000,000 debenture with a floating charge over all assets of the Company. As at March 31, 2005 the amount drawn on this credit facility was nil. This credit

5. Short-term debt *(Continued from previous page)*

facility has a sublimit of $100,000 for letters of credit or guarantee. The Company also has two letters of guarantee in the amounts of $10,000 and $20,000 that were issued to obtain oil and gas operator's license. These letters of guarantees mature in January 2006 and December 2006, respectively.

6. Future income taxes

Income tax recovery differs from the amount that would be expected by applying the current tax rate for the following reasons:

	2005	2004 (Restated)
Loss before income taxes	**(284,884)**	(132,264)
Expected tax recovery at 37.62% (2004 - 40.79%)	**(107,173)**	(53,950)
Increase (decrease) in income taxes resulting from:		
Crown charges	**35,142**	(5,243)
Resource allowance	**4,272**	-
Attributed Canadian Royalty Income	**(14,312)**	-
Stock-based compensation	**37,071**	18,132
Rate adjustment	**8,050**	(4,664)
Other	**30,059**	1,715
Future income tax recovery	**(6,891)**	(47,440)

At March 31, 2005, the Company has the following estimated tax pools available for deduction against future taxable income:

	2005	2004
Canadian oil and gas property expense	**1,267,438**	822,084
Canadian development expense	**150,136**	135,589
Canadian exploration expense	**254,983**	59,906
Undepreciated capital cost	**746,489**	257,866
Share issuance costs	**319,148**	37,461
Non-capital losses	**606,644**	212,190

6. Future income taxes *(Continued from previous page)*

The non-capital losses will expire as follows:

2007	5,611
2008	32,170
2009	122,363
2011	52,042
2012	368,251
2015	26,207

Future income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. The components of the Company's future income tax assets and liabilities are as follows:

Future tax assets	**2005**	*2004 (Restated)*
Share issue costs	**107,297**	14,056
Loss carry forwards	**195,143**	79,612
Asset retirement obligations	**35,205**	26,067
Attributed Canadian Royalty Income	**17,183**	2,871
Cumulative eligible capital	**1,022**	1,227
Future tax liability	**355,850**	123,833
Property and equipment	**(764,187)**	(76,393)
Future tax asset (liability)	**(408,337)**	47,440

7. Asset retirement obligations

	2005	*2004 (Restated)*
Balance, beginning of year	**69,475**	-
Additional obligations	**69,778**	64,329
Obligation settled	**(5,891)**	-
Accretion	**5,059**	5,146
Balance, end of year	**138,421**	69,475

Future asset retirement obligations are estimated based on the Company's net ownership interest in all wells and facilities, the estimated costs to reclaim

7. Asset retirement obligations *(Continued from previous page)*

and abandon the wells and facilities and the estimated timing of the costs to be incurred in future periods. The Company estimates the total undiscounted cash flows required to settle the obligations will be $517,088 (2004 - $299,835). The obligations have been discounted using a credit adjusted risk free rate of eight percent and an inflation rate of 1.5 percent per year. Most of these obligations are not expected to be paid until about 20 years in the future and will be funded from general Company resources at that time.

8. Share capital

Authorized
Unlimited number of voting common shares, without nominal or par value
Unlimited number of non-voting preferred shares.

Issued:

Common Shares	*Number*	*Amount*
Balance, December 31, 2002	2,655,000	311,992
Qualifying Transaction	4,250,000	637,500
Purchase of Cashel Resources Inc.	769,948	269,482
Share issuance cost		(24,368)
Balance as previously stated, March 31, 2004	7,674,948	1,194,606
Revision in purchase price of the Qualifying Transaction (Note 16)		(216,508)
Balance as restated, March 31, 2004		978,098
Flow-through shares issued (i)	5,714,200	1,999,970
Private placement (ii)	6,666,665	2,000,000
Shares cancelled on business combination (Note 3)	(4,250,000)	(420,992)
Shares issue on business combination (Note 3)	4,250,000	420,992
Warrants exercised	399,598	139,859
Agent options exercised	55,600	23,274
Fair value of share issue costs relating to agent options		(108,892)
Share issue costs		(371,046)
Effect of future income taxes on share issue costs		151,096
Effect of future income taxes on flow-through shares expenditures		(575,788)
Balance, March 31, 2005	20,511,011	4,236,571

8. Share capital *(Continued from previous page)*

(i) During the year, the Company completed a private placement of 5,714,200 common shares issued on a "flow-through" basis at a price of $0.35 per common share, for gross proceeds of $1,999,970. As at March 31, 2005, $1,721,638 of expenditures had been incurred with the full amount of the flow-through share issue being renounced to the shareholders. As part of the private placement, the agent was granted an option to acquire up to 571,420 common shares of the Company exercisable at a price of $0.35 per share for a period of 12 months from the closing date and subject to a four month hold period that expired on October 31, 2004. The amount of options at closing that were granted to the agent was 285,710 and their estimated fair value is $29,832 (Note 14).

(ii) During the year, the Company completed a private placement of 6,666,666 units at a price of $0.30 per unit, for gross proceeds of $2,000,000. Each unit consists of one common share and one share purchase warrant of the Company. As part of this private placement, the agent and sub-agent was granted an option to acquire 666,666 units of the Company exercisable at a price of $0.30 per unit for a period of 12 months from the closing date and subject to a four month hold period that expired on October 31, 2004. The estimated fair value of the agent options is $79,060. During the year the agent exercised 55,600 of its options (Note 14).

Escrow shares

The 1,650,000 Founders shares are held in escrow and will be released as to 10% thereof following acceptance of the Qualifying Transaction, and as to 15% thereof on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date of November, 2003. At March 31, 2005, 990,000 (2004 - 1,485,000) shares were held in escrow.

The 4,250,000 shares issued pursuant to the Qualifying Transaction to Spitfire Exploration Ltd. are subject to an Escrow Agreement dated November 11, 2003 and will be released as to 10% thereof following acceptance of the Qualifying Transaction (November 27, 2003) and as to 15% thereof on each of the 6th, 12th, 18th, 24th, 30th and 36th month anniversary dates following the initial release date of November 27, 2003.

8. Share capital *(Continued from previous page)*

At March 31, 2005, 2,550,000 (2004 - 3,825,000) shares were held in escrow.

Stock options
The Company has established a stock option plan whereby options may be granted to the Company's directors, officers and employees for up to 10% of the Company's issued and outstanding common shares. The exercise price of each option may equal the market price of the Company's common shares on the date of the grant less applicable discounts. The vesting and expiry terms are set by the Company's board of directors. The following summarizes information with respect to stock options outstanding:

Stock option transactions were as follows:

	Number of options	*Price Range*	*Weighted Average Exercise Price*	*Expiry Date*
Balance, December 31, 2002	465,000	0.20	0.20	2006
Options granted	425,000	0.15	0.15	2008
Options expired	(306,000)	0.20	0.20	2004
Balance, March 31, 2004	584,000	0.15-0.20	0.16	2006 to 2008
Options granted	1,296,500	0.19-0.35	0.20	2009
Balance, March 31, 2005	1,880,500	0.15-0.35	0.19	2006 -2009

As at March 31, 2005, the balance of options exercisable was 1,037,000 (2004 -487,000) and having a weighted average exercise price of $0.19 (2004 - $0.16).

Warrants
In connection with financing activities, the Company has the following warrants outstanding:

8. Share capital *(Continued from previous page)*

	Number of Warrants	Price Range	Weighted Average Exercise Price	Expiry Date
Balance, March 31, 2004	-	-	-	-
Granted	7,333,333	0.35	0.35	June 2005
Exercised	(399,598)	0.35	0.35	-
Balance, March 31, 2005 (Note 14)	6,933,735	0.35	0.35	June 2005

9. Contributed surplus

	2005	*2004*
Balance, March 31, 2004	**53,024**	-
Stock-based compensation *(Note 10)*	**135,128**	53,024
Fair value of agent options granted *(Note 8)*	**108,892**	-
Agent options exercised	**(6,594)**	-
Balance, March 31, 2005	**290,450**	53,024

10. Stock-based compensation

The Company accounts for stock options granted after December 31, 2002 to directors and officers using the "fair value method", whereby stock-based compensation is recorded equal to the fair value of the options granted. During the year 1,296,500 options (fifteen month period ending March 31, 2004 - 425,000) were granted, having various vesting periods. The estimated fair value of the options granted during the year was $253,497 (fifteen month period ending March 31, 2004 -$67,673). A total of $98,540 (fifteen month period ending March 31, 2004 -$44,452) has been recorded as a stock-based expense and $36,588 (fifteen month period ending March 31, 2004 - $8,572) has been capitalized, based on 704,000 (fifteen month period ending March 31, 2004 - 333,000) options vesting during the year. The total of $135,128 (fifteen month period ending March 31, 2004 - $53,024) has been offset to contributed surplus. As at March 31, 2005, the unamortized fair value of the non-vested options is $85,855 (2004 - $14,649).

10. Stock-based compensation *(Continued from previous page)*

The fair value of options granted was estimated at the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

	2005	*2004*
Risk free interest rate (%)	**4.0% to 4.25%**	4.07%
Expected volatility (%)	**100%**	100%
Expected life (years)	**5**	5
Expected dividend yield (%)	**0%**	0%

Option pricing models require the input of highly subjective assumptions including the expected price volatility. Changes in the subjective input assumptions can materially affect the fair value estimate, and therefore, the existing models do not necessarily provide a reliable measure of the fair value of the Company's stock options.

11. Debenture payable

During the prior year, the Company issued a $200,000 unsecured debenture bearing interest at prime plus 2% and redeemable at the option of the Company at $0.50 per common share. This debenture was paid in full with interest on February 22, 2005.

12. Related party transactions

During the year, the following amounts were paid to companies in which directors or officers of the Company are either principals or owners of a significant interest in the related company:

	Property and equipment	*General and adminis-trative*	*Financing*	***2005 Total***	*2004 Total (Restated)*
Land	-	73,235	4,713	**77,948**	28,012
Legal	753	36,376	39,391	**76,520**	25,967
Geological & Geophysical	68,364	9,676	-	**78,040**	6,106
Accounting	-	81,327	614	**81,941**	14,341
General and administrative	-	96,249	2,567	**98,816**	51,541
	69,117	296,863	47,285	**413,265**	125,967

12. Related party transactions *(Continued from previous page)*

Included in accounts payable and accrued liabilities is $20,605 (2004 - $29,560) relating to the above transactions. The above transactions were conducted in the normal course of operations and measured at the exchange amount, which is the amount of consideration established and agreed to by the related parties.

13. Financial instruments

The Company, as part of its operations, carries a number of financial instruments. It is management's opinion that the Company is not exposed to significant interest (except on its bank loans), or currency risk arising from these financial instruments.

Fair value

The fair value of the Company's cash, accounts receivable, accounts payable and accrued liabilities and debenture payable approximates their carrying value due to the short-term nature of these instruments. The carrying values of the Company's short-term debt approximate its fair values because interest charges under the terms of the debt are based upon current Canadian bank prime rates.

Fair values are based on management's best estimate after consideration of current market conditions. The estimates are subjective and involve considerable judgment, and as such are not necessarily indicative of the amounts that the Company may incur in actual market transactions.

Credit risk

Virtually all of the Company's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risks.

14. Subsequent events

Subsequent to the period end, the Company granted 250,000 stock options to acquire common shares at a price of $0.40 per share under the terms of the Company's approved employee Stock Option Agreement.

14. Subsequent events *(Continued from previous page)*

Also, 571,066 agent options were exercised at $0.30 per share for total cash consideration of $171,319 and 1,960,667 warrants were exercised at $0.35 per share for total cash consideration of $686,233. The balance of the warrants outstanding expired subsequent to March 31, 2005.

15. Contingency

The Company and Spitfire Exploration Ltd. has been named as defendants in a Statement of Claim filed. Various forms of relief are being claimed including damages in the sum of $1,000,000, an accounting for all production on certain lands, certain special and punitive damages in the sum of $50,000 each and costs and interest. The claims have been defended completely as having no merit and a counterclaim has been issued for amounts expended by the Company for costs relating to certain lands held jointly by the Plaintiffs, loss of profits and revenues for the lands, punitive damages, interest and legal costs.

16. Accounting correction of the Qualifying Transaction

During the year, the Company determined the the accounting treatment of the 2004 Qualifying Transaction with a related party should have been recorded at the carrying value of the assets acquired and not at the modified exchange amount calculated. The prior period has been restated and resulted in a decrease of share capital by $216,508, decrease of property and equipment by $207,947, decrease to depletion, depreciation and accretion of $8,561 and a decrease in the opening deficit of $8,561.

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